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Recent Accounting Standard Setting Changes for Consolidated Financial Statements

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***Abstract*—**In the current context of globalization, a large number of companies sought to develop as a group in order to reach to other markets or meet the necessary criteria for listing on a stock exchange. The issue of consolidated financial statements prepared by a parent, an investor or a venture and the financial reporting standards guiding them therefore becomes even more important. The aim of our paper is to expose this issue in a consistent manner, first by summarizing the international accounting and financial reporting standards applicable before the 1st of January 2013 and considering the role of the crisis in shaping the standard setting process, and secondly by analyzing the newly issued/modified standards and main changes being brought.

***Keywords*—**Consolidated financial statements, control, IFRS 10, financial crisis.

I. Introduction

GIVEN the phenomenon of globalization, the concept of group and hence the consolidated financial statements has become a subject increasingly discussed. Large companies have sought to develop both at national level and beyond the country of origin with the aim to conquer new markets and thereby to become internationally recognized.

Obviously, in order to be traded on various stock exchanges, companies have to meet certain criteria, which are more easily reached through a group in which eventually assets, liabilities and results of several companies controlled by a parent entity are viewed as a whole.

Not seldom there were cases where, in order to increase the value of the company and of its shares, were used various practices which mislead the users of accounting information. Financial statements considered separately may look better than they actually are in reality by incorporating some operations that occur within the group. However through the consolidated financial statements these operations are eliminated thus ensuring more transparency.

In this paper we attempted to analyze the international accounting and reporting standards applicable in preparing consolidated financial statements. Thus, we realize a synthesis of the standards used prior to the 1st January 2013, subsequently we frame this topic in the context of the recent economic and financial crisis and eventually the main changes in guidance brought by the newly issued standards were presented.

The public opinion was shocked at the beginning of the millennium by the dramatic financial scandals involving true giants of the world economy such as Enron, Parmalat, WorldCom, etc. The fact is that misinterpretation and misapplication, with or without intent, of the provisions of standards led to the presentation of some financial statements that were far from reflecting the financial position of the companies concerned. Massive accounting fraud exposed weakness of global corporate governance, audit and control systems and financial reporting mechanisms [1]-[3].

Accounting harmonization process and emphasis placed increasingly often on the importance of the international accounting standards and accounting information presentation perfectly consistent with what it reflects are actually answers of the regulatory bodies in the course of globalization and control of disclosures in the financial statements. Thus, international regulatory bodies have been mobilized in an attempt to provide to the actors of economic world a package of guidelines, laws, regulations and standards as efficient as possible with a pivotal role in corporate governance and accounting disclosures.

It remains to be seen the extent to which new regulations and / or changes in the application of the current standards will prevent similar cases of corporate failure and fraud such as those mentioned above and whether we will see adjustments in the behavior of those should be the gatekeepers of the economic world. The pace at which economic realities are developing requires the assumption of several measures that keep up with the developments. Thus, were taken a number of measures to prevent and control fraudulent practices, particularly those involving financial engineering mechanisms using techniques for consolidating the accounting of groups of entities and special purpose entities.

In what concerns the methodological aspects, this paper is the result of a qualitative research on the international accounting and reporting regulation on the consolidated statements, the impact of the recent financial crisis on this field and the main changes of the standards applicable starting with 1st January 2013.

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II. Regulation Prior Financial Crisis

The international accounting standards providing guidance for the preparation and presentation of consolidated financial statements, before 1st of January 2013, are as follows:

- IAS 27 Consolidated and Separate Financial Statements [4], [5]
- SIC-12 Consolidation – Special Purpose Entities [6]
- IAS 31 Interests in Joint Ventures [7]
- IAS 28 Investments in Associates [8]
- IFRS 3 Business Combinations [9], [10]

Accounting standard IAS 27 Consolidated and Separate Financial Statements was issued in 1989. The aim of IAS 27 was to increase the relevance, reliability and comparability of consolidated financial statements prepared by a parent for a group of entities they control and separate financial statements (unconsolidated) that a parent, an investor or venturer is required to provide [11].

IAS 28 Investments in Associates was issued in April 1989 and afterwards revised in December 2003. IAS 31 Interests in Joint Ventures had the goal of providing guidance for accounting an entity's interests in different forms of joint ventures. The objective of IFRS 3 Business Combinations is to enhance the relevance, reliability and comparability of the information regarding a business combination and its effects drawn from financial statements [9].

SIC-12 Consolidation – Special Purpose Entities represents in fact an interpretation of the accounting standards IAS 27, addressed to the cases in which a special purpose entity should be consolidated by a reporting entity respecting the consolidation principles in IAS 27 [6].

III. Effects of Financial Crisis on Approached Area

The global financial crisis has highlighted the need to increase the requirements for the provision of information in the financial statements, especially in what concerns the so-called "special purpose entities" (SPEs).

Actually, the first reason for issuing IFRS 10 as mentioned even in the preamble of the standard is the need to treat the divergence in practice when applying IAS 27 and SIC-12. For example, entities ranged in applying the concept of control in circumstances where a reporting entity controls another entity, but holds less than half of the voting rights of the entity and in circumstances in which it was involved the agency relationship [12].

The global financial crisis that began in the year 2007 revealed the lack of transparency on the risks to which were exposed investors through the involvement taken into "off balance sheet vehicles" (such as securitization vehicles), including those that have set up or have sponsored. Consequently, the G20 leaders, the Financial Stability Board and others have asked the Council to review the provisions on accounting and disclosures for such "off balance sheet vehicles" [12]. A significant number of studies in recent years analyze the financial crisis from different perspectives, documenting its impact [13].

Therefore the consolidation standard IFRS 10 was part of the "crisis projects" led by IASB and as can be seen in the following figure, although it was added to the agenda in 2003, there was almost no progress until 2008.

IV. Current State of Affairs

The international accounting and reporting standards applicable after 1st of January 2012 are the following:

- IFRS 10 Consolidated Financial Statements [12]
- IFRS 12 Disclosure of Interests in Other Entities [14]
- IAS 28 Investments in Associates and Joint Ventures [8]
- IFRS 11 Joint Arrangements [15]
- IFRS 3 Business Combinations [10]

IFRS 10 Consolidated Financial Statements establishes the principles for the preparation and presentation of consolidated financial statements when the parent entity controls one or more subsidiaries. The standard establishes an unitary model for consolidation that applies to all types of entities. The objective of IFRS 10 was to solve the disputes arising in practice from application of IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation - Special Purpose Entities. Principles of IAS 27 and SIC-12 were not always applied consistently. There were developed different interpretations of some of the requirements of IAS 27 and SIC-12 and was often difficult to determine which of the two standards apply to certain entities [16].

IFRS 12 Disclosure of Interests in Other Entities set disclosure requirements for entities that have interests in subsidiaries, joint arrangements (joint operations or joint ventures), associates or unconsolidated structured entities [14].

IFRS 11 Joint Arrangements outlines the accounting by entities that jointly control an arrangement. Joint control involves the contractual agreed sharing of control and arrangements subject to IFRS 11 are classified as either a joint venture (representing a share of net assets and equity accounted) or a joint operation (representing rights to assets and obligations for liabilities, accounted for accordingly) [15].

Accounting standard IFRS 10 sets out the control as the basis for determining which entities are consolidated in the consolidated financial statements and further define the concept of control.

Therefore, according the definition given by IFRS 10, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee [12]. Therefore, the principle of control sets out the following three elements of control:

a) Power over the investee;
b) Exposure, or rights, to variable returns from involvement with the investee; and
c) The ability to use power over the investee to affect the amount of the investor's returns [12].

Previously, control through voting rights was addressed by IAS 27, while exposure to variable results was reflected in SIC 12. However, the relationship between these two approaches has never been clear. IFRS 10 manages to connect power and returns by introducing the additional requirement that the

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investor have the ability to exercise that power to influence the returns [17].

Determining the purpose and design of the investee influences the identification of relevant activities, how decisions on these activities are taken, who can conduct these activities and who can get the returns.

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's returns [18].

In Appendix B of IFRS 10 (paragraph B15) there is a list of activities that, either individually or in combination, provide authority investor:

a) Rights in the form of voting rights (or potential voting rights) of an investee;
b) Rights to appoint reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;
c) Rights to appoint or remove another entity that directs the relevant activities;
d) Rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
e) Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities [16].

We have to mention that obviously the list above is not exhaustive. Also, when assessing the power of an investor are taken into consideration only substantive rights (the protective rights are not considered) relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise that right [12]. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective [12].

The main similarities and differences between the standards applicable to consolidated financial statements previously and subsequently to the recent financial crisis are presented in Table I presents a summary of the main changes occurring in the international accounting standards used in preparing consolidated financial statements.

TABLE I
COMPARISON BETWEEN THE STANDARDS APPLICABLE TO CONSOLIDATED FINANCIAL STATEMENTS PREVIOUSLY AND SUBSEQUENTLY TO THE RECENT FINANCIAL CRISIS

Topic	IAS 27 and SIC-12	IFRS 10
Scope	IAS 27 applies to all control assessments but is interpreted by SIC-12 for Special Purpose Entities (SPEs). IAS 27 applies to both consolidated and separate financial Statements.	IFRS 10 is the single source of consolidation guidance for all types of investee, including those to which SIC-12 applied. IFRS 10 applies only to consolidated financial statements. Requirements on preparing separate financial statements are retained in IAS 27.
Control definition	Control is the power to govern the financial and operating policies of another entity so as to obtain benefits from its activities.	An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee
Consolidation procedures	IAS 27 sets out procedures such as elimination of intragroup balances as transactions in order to achieve a 'single economic entity' presentation. IAS 27 includes requirements on changes of ownership without loss of control, and loss of control.	no change in IFRS 10
Control with voting rights/de facto control	IAS 27 includes a presumption that ownership of more than 50% of an investee's voting power gives control. IAS 27 has no explicit guidance on control via a large minority holding ('de facto control').	Under IFRS 10 control is conferred by more than 50% of voting rights if substantive and the investee's relevant activities are directed by voting rights. IFRS 10 includes explicit guidance that a large minority holding may confer control where other shareholdings are widely dispersed.
Special Purpose Entities (SPEs)	SIC-12 defines SPEs and provides specific interpretive guidance. SIC-12's indicators of control include 'risks and rewards' and 'autopilot'.	SPEs are not defined in IFRS 10. IFRS 10's general principles apply to entities previously covered by SIC-12. IFRS 10 does include guidance on situations in which voting or similar rights are not the dominant factor in deciding who controls the investee.
Potential voting rights (PVRs)	Under IAS 27 PVRs may convey or contribute to control if currently exercisable.	Under IFRS 10 PVRs may convey or contribute to control if 'substantive'.
Delegated power (principal-agent situations)	IAS 27 has no guidance.	IFRS 10 includes extensive guidance on whether an investor is a principal or an agent. An investor engaged primarily to act on behalf of other parties (i.e. an agent) does not control the investee.

Source: [18]

V. CONCLUSION

In this paper we addressed the issue of consolidated financial statements from the perspective of regulation and guidance provided by the International Accounting Standards Board. We attempted to analyze the changes in regulation in the context of recent financial and economic crisis.

Therefore, one important problem highlighted by the crisis is the lack of transparency on the risks to which were exposed investors through the involvement taken into "off balance sheet vehicles", such as securitization vehicles. It can be said that in a way or another financial crisis accelerated certain mechanisms and lead to the improvement of regulation and guidance concerning consolidated financial statements.

In another train of thoughts, our goal was to present this issue in a consistent manner, firstly by summarizing the international accounting and reporting standards applicable before the 1st of January 2013 and by emphasizing the role of the crisis in the standard setting process, and secondly by analyzing the newly issued/modified standards and the most important changes they brought.

In the light of those already stated, it should be noted that IASB has made efforts to issue a new accounting standard on consolidated financial statements with the scope of bringing consistency in practice and enhancing the relevance, reliability and comparability of accounting information in financial statements prepared by a parent company for the group of entities it controls and separate statements (unconsolidated) that a parent, investor or venturer prepares.

Thus in May 2011 it has been issued IFRS 10 Consolidated Financial Statements, the standard establishes principles for the preparation and presentation of consolidated financial statements when the parent entity controls one or more subsidiaries. The standard establishes an uniform model for consolidation that applies to all types of entities. The objective of IFRS 10 was resolving disputes in practice arising from application of IAS 27 and SIC-12.

As can be seen based on the changes in regulation presented in this work, the guidance provided by IFRS 10 is more complete and more consistent than that provided by the previously applicable consolidation standards.

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